No. 89-390 (18)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PENSION BENEFIT GUARANTY CORPORATION,
Petitioner,

v.

THE LTV CORPORATION; LTV STEEL COMPANY, INC.; THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF LTV STEEL COMPANY, INC. AND CERTAIN AFFILIATES; PARENT CREDITORS COMMITTEE OF THE LTV CORPORATION; LTV BANK GROUP; OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS; BANCTEXAS DALLAS, N.A.; FIFTH THIRD BANK; HUNTINGTON NATIONAL BANK; CITIBANK, N.A.; DAVID H. MILLER AND WILLIAM W. SHAFFER,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF LTV STEEL COMPANY, INC. AND CERTAIN AFFILIATES

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QUESTIONS PRESENTED

1. Did the Court of Appeals properly find that the decision of the Pension Benefit Guaranty Corporation (the "PBGC") to restore three involuntarily terminated pension plans sponsored by LTV Steel Company, Inc. was arbitrary and capricious because it failed to consider properly the affordability and viability of the restored plans, and was unsupported by the administrative record below?

2. Did the Court of Appeals properly find that the restoration decision of the PBGC was arbitrary and capricious because it failed to give adequate consideration to the bankruptcy and labor law implications of its decision?

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On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR RESPONDENT THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF LTV STEEL COMPANY, INC. AND CERTAIN AFFILIATES

STATEMENT OF THE CASE

LTV's Bankruptcy

On July 17, 1986, The LTV Corporation ("Parent"), LTV Steel Company, Inc. ("LTV Steel") and substantially all of their affiliates (Parent, LTV Steel and their affiliates, collectively "LTV") filed petitions for reorganization under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). At that time, LTV Steel was the second largest steel company in the United States, having been created by the merger of Jones & Laughlin Steel Company, Youngstown Sheet & Tube Company and Republic Steel Corporation. However, the pressures of surviving in an industry battered by foreign competition proved too much, and by 1986 LTV was suffering from record losses in the steel business, a weak dollar, declining steel shipments and the tightening of its credit. It was faced with impending defaults under its credit agreements, and its bank lines had been terminated.

At the time it filed its Chapter 11 petitions, LTV was burdened by massive pension and other obligations. Each of LTV Steel's predecessor companies had brought its pension and other obligations to the merged entity. To reduce costs and improve efficiency, LTV Steel had shut down extraneous facilities, thereby triggering additional obligations to those employees who were laid off. As a result, LTV Steel's growing pension and retiree health liabilities rested on an ever shrinking base. By 1986, LTV Steel's operations employed 24,544 active workers but supported 77,182 retirees, more than three retirees for each worker. Calculated under the Employee Retirement Income Security Act of 1974, as amended through 1986 ("ERISA")[1], the total present value of LTV Steel's unfunded liabilities for pension costs attributable to pre-Chapter 11 services and events was estimated in 1986 to exceed $2 billion. JA 138.[2]

[1] ERISA was subsequently amended by the Pension Protection Act (the "PPA"), Pub. L. No. 100-203 (Omnibus Budget Reconciliation Act of 1987), title IX, subtitle D, part II, 101 Stat. 1330-33 (1987), but the PPA and later amendments are not applicable to the computation of the claims filed by the PBGC against LTV. Unless otherwise specified, all references herein are to ERISA as in effect in 1986.

Upon the commencement of its Chapter 11 cases, LTV continued to operate its businesses as debtors-in-possession for the benefit of, and as a fiduciary for, its creditors and equity security holders. In Chapter 11, LTV's principal objectives are to (a) rehabilitate and streamline its businesses so as to maximize their value and (b) confirm and consummate plans of reorganization in accordance with the provisions of Chapter 11 that provide a fair recovery for all of its creditors, including the PBGC. In order to afford Chapter 11 debtors a "breathing spell" to effect a reorganization and to help assure equality of distribution among creditors, the Bankruptcy Code generally forbids a debtor from paying its pre-petition obligations except pursuant to a confirmed plan of reorganization. Thus, upon filing its Chapter 11 petitions, LTV was prohibited from making contributions to its pension plans attributable to pre-petition services or events, just as it was prohibited from making payments on its other pre-petition unsecured claims.

In order to emerge from Chapter 11, LTV must confirm plans of reorganization providing for the treatment of claims in accordance with the requirements of Section 1129 of the Bankruptcy Code. All claims against LTV that arose before the date its plans of reorganization are confirmed can be discharged by such plans, pursuant to Bankruptcy Code Section 1141(d)(1). Because LTV is insolvent by a large margin, it is expected that general unsecured creditors will receive substantially less than full payment on their claims.

Interests of the Committee

The Official Committee of Unsecured Creditors of LTV Steel Company, Inc. and Certain Affiliates (the "Committee")

[2] Citations preceded by "JA" refer to the Joint Appendix; those preceded by "Pet. App." refer to the Appendix to the Petition for Certiorari; and those preceded by "AR" refer to the Administrative Record.

was appointed by the Bankruptcy Court to represent the interests of all of the unsecured creditors of LTV Steel and its steel-related affiliates. The Committee represents thousands of creditors who in the aggregate hold claims in excess of $3 billion (not including the claims of the PBGC). These creditors include suppliers of goods and services, noteholders, employees, retirees and others.

The crux of this case is that, by unilaterally restoring three major underfunded pension plans which it had previously terminated, the Jones & Laughlin Hourly Pension Plan, Jones & Laughlin Retirement Plan, and Pension Plan of Republic Steel Corporation Dated and Effective as of March 1, 1950 (collectively, the "Plans"), the PBGC has attempted to have itself preferred over all other creditors by excluding the major part of its claims against LTV from the discharge provisions of the Bankruptcy Code and the recovery shortfalls to which the claims of all other creditors are subject. The PBGC believes that, by restoring the Plans, it can avoid, at least temporarily, having to pay to beneficiaries of the Plans more than $2 billion of benefits it has guaranteed pursuant to ERISA in excess of the value of the assets of the Plans.

The PBGC's legal theory is that, if the Plans are not terminated during the pendency of LTV's Chapter 11 cases, LTV's obligations for the underfunding of the Plans will not be discharged by confirmation of LTV's plans of reorganization and, thus, the PBGC cannot be forced to accept less than full payment on its claims. Under this theory, even if the restored Plans are reterminated shortly after LTV emerges from Chapter 11, the PBGC would be far better off than if restoration had not occurred. The PBGC would upon retermination have the benefit of the fact that the claims of all other creditors would previously have been discharged in the Chapter 11 case at a substantial discount. Moreover, by reason of changes in ERISA enacted after the original termination date, the PBGC's claims against LTV for each dollar of its guaranty liability would be substantially larger upon retermination than the original termination—even if the Plans are reterminated

before LTV emerges from Chapter 11. *Compare* ERISA Section 4062 before and after enactment of the PPA (removal of seventy-five percent cap on termination liability under Section 4062 (b)). Consequently, the PBGC's pecuniary interests favor restoration regardless of whether the restored Plans are affordable and viable.

The Committee intervened in this action because the PBGC's maneuver to circumvent the Bankruptcy Code in this manner and thwart LTV's attempt to resolve its pension liabilities as part of its Chapter 11 reorganization will, if successful, result in LTV's other creditors bearing the losses that the PBGC evades and, in all likelihood, destroy any prospect for a successful reorganization of LTV.

Termination of the Pension Plans

At the outset of its Chapter 11 cases, LTV recognized that it would need to resolve its massive pension obligations if it was to have any chance to reorganize successfully. LTV decided to seek to terminate its major underfunded pension plans in order to stem the growth of pension obligations and fix its pension plan termination liability to the PBGC under ERISA resulting from the underfunding. *See* 29 U.S.C. §1362. Fixing the PBGC's claims in this manner would facilitate treatment of those claims in a plan of reorganization in accordance with the provisions of Chapter 11.

Inasmuch as its hourly pension plans were established pursuant to collective bargaining agreements with the United Steelworkers of America (the "USWA"), LTV Steel was required under ERISA to bargain with the USWA before terminating its hourly pension plans. 29 U.S.C. §1341(a)(3); *See also* 11 U.S.C. §1113. Therefore, shortly after the Chapter 11 filing, LTV Steel approached the USWA to seek renegotiation of their 1986 collective bargaining agreement. AR 238. The USWA was adamantly opposed to renegotiation and would not support termination of the hourly pension plans. *Id.*

Thus, although LTV was prohibited as a matter of bankruptcy law from making contributions to its pension plans relating to pre-petition services and events, each month $31 million of benefits was being paid out of these plans. Uneconomic facilities continued to close and each day the pension liabilities increased by virtue of the further accrual of benefits and the additional benefits triggered by plant closings.

By September 1986, one of the salaried pension plans, the Republic Retirement Plan, was totally depleted of assets. The PBGC moved under the involuntary termination provisions of Section 4042 of ERISA to terminate the plan. AR 1.

In December 1986, the PBGC projected that LTV's status as a Chapter 11 debtor-in-possession would enable it to accumulate "just over $1 billion by the end of 1988," but understood that such cash could not be sufficient to both "finance a plan of reorganization and the ongoing [pension] [p]lans." AR 4. As a result, on January 12, 1987, in order to "avoid an unreasonable deterioration of the Plans' financial condition or an unreasonable increase in the liability of the PBGC's insurance funds," the PBGC moved to involuntarily terminate the three Plans which are the subject of this proceeding. Pet. App. 42a. LTV consented to the terminations. Pet. App. 42a. The PBGC then filed claims exceeding $2 billion against each of the LTV debtors, and increased its already intensive involvement in the reorganization process. If the Plans remain terminated, those claims, along with those of all other general unsecured creditors, will be dealt with pursuant to plans of reorganization for the LTV debtors. The recovery by the PBGC on its claims pursuant to such plans of reorganization will, under any conceivable scenario, far exceed the eight percent average recovery historically realized by the PBGC on its claims in bankruptcy cases. Brief of Solicitor General at 16 n.10.

The 1987 Interim Labor Agreement

The PBGC guarantees some, but not all, benefits under a terminated defined benefit pension plan. In this case, the

PBGC's involuntary terminations caused severe loss of pension and other employee benefits to approximately fifteen percent of LTV Steel's retirees. Active workers not only lost benefits under the terminated Plans, they also had no vehicle for the accrual of pension benefits for service performed following termination of the Plans. Pet. App. 42a; AR 479-80. The USWA opposed the terminations, appealed the termination orders, Pet. App. 43a n.9,[3] and initiated an adversary proceeding in the Bankruptcy Court alleging that LTV Steel had violated the labor contract and Section 1113 of the Bankruptcy Code (relating to rejection of collective bargaining agreements in Chapter 11 cases). Pet. App. 8a; AR 694.

The plan terminations and resultant loss of benefits provided the impetus for renewed bargaining between the USWA and LTV Steel. LTV Steel was concerned that USWA might strike, at an estimated cost to LTV of $100 million per month.[4] Pet. App. 8a; AR 1574. After weeks of intense and complicated negotiations, an interim agreement was reached. Not only was a strike averted, but the USWA made significant concessions in a number of areas which ultimately would generate annual savings to LTV Steel estimated at approximately $50 million. Pet. App. 45a. In return, LTV Steel agreed to several new programs designed, in part, to replace some of the non-guaranteed benefits lost as a result of the

[3] The PBGC defended the terminations before the Court of Appeals for the Second Circuit which, on July 17, 1987, affirmed the involuntary termination orders. *Jones & Laughlin Hourly Pension Plan v. LTV Corp.*, 824 F.2d 197 (2d Cir. 1987) and *Jones & Laughlin Retirement Plan v. LTV Corp.*, 824 F.2d 202 (2d Cir. 1987).

[4] LTV's concern that the USWA might strike was well-founded. The USWA had struck the Wheeling-Pittsburgh Steel Company, another Chapter 11 debtor, in part for its failure to pay post-termination pension benefits, and had just concluded a six-month strike at USX Corporation, the nation's largest steel company. Pet. App. 43a. Indeed, at the very beginning of the LTV cases the USWA had struck LTV Steel's most important facility in response to LTV Steel's initial inability to pay retiree medical benefits. *In re Chateaugay Corp.*, 87 B.R. 779, 789 (S.D.N.Y. 1988). LTV Steel thereupon obtained court authority to pay those benefits. *In re Chateaugay Corp.*, 64 B.R. 990 (S.D.N.Y. 1986).

involuntary terminations of the Plans.[5] *Id.* The 1987 labor agreement is expressly designated as an interim arrangement. *Id.* A new labor agreement must be negotiated to govern the parties' relationship following LTV's emergence from Chapter 11, and that agreement will be the subject of bargaining at the same time as a plan of reorganization is completed with all of LTV's creditors. AR 241.

Nonetheless, the PBGC took the position that unspecified aspects of the proposed agreement violated a PBGC "policy" against post-termination benefits and, therefore, was abusive. LTV, the PBGC and the USWA held several meetings in July 1987 in an effort to clarify and resolve the PBGC's objections to the proposed agreement, but the PBGC was unwilling or unable to specify its objections to the collective bargaining agreement. Pet. App. 49a-50a; AR 523-24, 658. The validity of the post-termination pension arrangements was the only matter at issue; LTV Steel's financial status was not discussed. Pet. App. 125a-26a.

Bankruptcy Court Approval of The 1987 Interim Agreement

LTV Steel promptly sought Bankruptcy Court authorization to enter into the interim labor contract. The PBGC attempted, unsuccessfully, to prevent the Bankruptcy Court from considering the matter, and then argued in the Bankruptcy Court in opposition to the 1987 interim agreement. At the hearing on LTV Steel's application, LTV's witnesses testified without contradiction that the interim agreement was necessary to avoid a crippling strike and to give LTV a chance to reorganize. Pet. App. 45a. On July 16, 1987, the Bankruptcy Court approved the interim labor agreement, including the post-termination pension arrangements.

[5] The new programs, which do not provide a full recovery of the level of benefits lost, also differ substantively from the terminated Plans, most notably in that none of the new programs is a defined benefit plan and none of the programs is guaranteed by the PBGC.

Restoration

On eight occasions the PBGC unsuccessfully attempted in the Bankruptcy Court, the District Court and the Court of Appeals to stay approval and implementation of the collective bargaining agreement. The PBGC appealed the order approving the interim agreement to the District Court, raising its abuse argument. After LTV moved to dismiss the appeal, the PBGC, without explanation withdrew the appeal without prejudice to renewal and, thus, abandoned its efforts to obtain judicial vindication of its asserted policy against certain post-termination pension arrangements. At the same time, the PBGC was attempting, unsuccessfully, to obtain Congressional sanction for its policy.

Following these actions, the Board of Directors of the PBGC held a 15 minute telephone meeting, its first meeting in eight years, AR 598, and gave blanket approval for any restoration action the PBGC Executive Director might choose to take. Pet. App. 49a. Thereafter, on September 22, 1987, the Executive Director sent LTV the first Notice of Restoration ever issued by the PBGC. AR 1578-79; Pet. App. 125a. The Notice purported to restore the terminated Plans. Pet. App. 125a.

The PBGC's Analysis

The PBGC asserted three bases for restoration: (1) LTV Steel's "abuse" of ERISA in establishing the post-termination pension arrangements negotiated with the USWA and approved by the Bankruptcy Court; (2) "LTV Steel's improved financial circumstances," and (3) "LTV Steel's demonstrated willingness to fund employee retirement arrangements."[6] AR 1578. No further explanation or analysis was set forth in the Notice of Restoration.

[6] The PBGC subsequently abandoned its "demonstrated willingness" argument before the Court of Appeals, and no longer relies on it as a basis for restoration. Pet. App. 25a.

As the District Court and the Court of Appeals found, the administrative record reveals a haphazard process of inadequate factual development and faulty analysis. The PBGC relied upon fewer than ten pages of the "administrative record" to explain its administrative action. Fewer than forty pages reflect regulatory consideration, as opposed to pre-existing documents relating to creditor/adversary action. AR 1-14a, 637-45, 1154-55, 1577-84. The basis for the PBGC's finding of "abuse" is set forth in three conclusory paragraphs of one PBGC affidavit. AR 224-25. Three pages of another document record a rudimentary financial "analysis," comparing a projection of LTV Steel's cash flow and the minimum cash needed to fund the Plans. AR 12-13.

Incredibly, the PBGC's own administrative record shows that its decisions first to terminate the Plans in January 1987 and then to restore the Plans in September of the same year were based on the same LTV two-year business plan. Pet. App. 112a-13a. Moreover, the PBGC knew that a revised and updated seven-year business plan would be made available imminently. Pet. App. 128a n.46. With reference to that two-year business plan, the PBGC staff stated at the first meeting to discuss restoration that at the time of termination a "financial analysis presented to the group based on LTV's most optimistic projections indicated that LTV could not make the required contributions to meet the minimum funding requirements." Pet. App. 113a n.37. The only additional information considered by the PBGC at the time of restoration was LTV Steel's performance and its accumulation of cash during the first five months of 1987. Pet. App. 113a.

Effect of Restoration

Almost two and one-half years have passed since the PBGC issued its Notice of Restoration. Through restoration, the PBGC is essentially seeking to exclude its claims from being dealt with on a par with the claims of other creditors in the LTV Chapter 11 cases. Because of the size of the PBGC's

claims and their pivotal role in the Chapter 11 cases, the PBGC's unilateral restoration decision has put the LTV Chapter 11 cases—along with the hopes of thousands of other creditors to receive reasonably timely recovery on their claims—into a prolonged state of limbo. Thus, three and one-half years after these Chapter 11 cases were commenced, no plans of reorganization have been filed, creditors holding billions of dollars of pre-petition unsecured claims have not received any recovery from LTV and the fate of the third largest steel producer in the United States (as well as a major defense and aerospace contractor) has been furtherjeopardized.

Had the PBGC continued on its course of attempting to enforce its "policy" on "abusive follow-on plans" through judicial means by continuing its appeal from the order approving the interim collective bargaining agreement, no such result would have ensued. The courts would have determined the legitimacy of the challenged post-termination pension arrangements under applicable law, and such arrangements would ultimately have been validated or discontinued. In either event, LTV's reorganization could have progressed. Instead, by reason of its selection of the extraordinary and unprecedented restoration remedy, the PBGC has caused the Chapter 11 process to grind almost to a halt. Consequently, all other creditors have been exposed to inordinate risk, delay and expense.

The Decision Below

The PBGC filed a complaint in the District Court for the Southern District of New York seeking enforcement of its administrative restoration, and moved for summary judgment. In its papers, the PBGC stated that if the Plans were restored LTV would have to resume funding the Plans immediately. On June 22, 1988, District Judge Sweet issued an opinion denying summary judgment and vacating the Notice of Restoration. Pet. App. 28a. Judgment remanding the mat-

ter to the PBGC was entered on September 13, 1988. Pet. App. 132a. The PBGC appealed the judgment to the Court of Appeals for the Second Circuit, which issued a decision affirming the District Court decision. Pet. App. 1a.

The Court of Appeals found the PBGC's restoration of the LTV Plans was arbitrary and capricious on numerous grounds:

1. The agency failed to "adequately [consider] the policies and goals of the bodies of law involved in this case" —ERISA, bankruptcy law and labor law—"and their interaction with each other," Pet. App. 17a.

2. "Even when we examine the factors upon which PBGC did base its decision, we find no support in the administrative record for the conclusion reached," Pet. App. 17a, specifically finding that:

a. The PBGC had no support in the administrative record for its conclusion that the post-termination pension arrangements were abusive "follow-on" plans. Pet. App. 19a.

b. The PBGC's "financial improvement" rationale was based on "fundamental, yet unexplained and unexamined assumptions." Pet. App. 22a.

c. The PBGC "did not effectively assess the impact that LTV's status as a debtor in Chapter 11 reorganization had on its financial condition." Pet. App. 23a.

d. "[N]owhere in the administrative record is there any evidence that PBGC assessed the possibility that the Plans would have to be re-terminated." Pet. App. 25a.

e. "PBGC neither apprised LTV of the material on which it was to base its decision, gave LTV an adequate opportunity to offer contrary evidence, proceeded in accordance with ascertainable standards ... nor provided a statement showing its reasoning in applying those standards." Pet. App. 26a.

Perhaps the most significant aspect of the Court of Appeals' decision is its recognition that the "[p]ension benefits accrue to employees as a result of their past labor on behalf of [LTV]" and, therefore, "any claims arising out of LTV's obligation to pay into the pension fund plans are pre-petition debts." Pet. App. 23a. "Pre-petition debts are satisfied by a fair distribution of the debtor's assets . . . among the creditors, with the pension plans receiving no special priority." Pet. App. 23a-24a. The Court pointed to the PBGC's failure to consider that "[w]hen all the pre-petition claims of LTV's other creditors are considered, and they receive their fair share of any additional funds, LTV's apparent ability to fund the Plans suffers," as further evidence that the PBGC's decision to restore the Plans was made without regard to the viability of the restored Plans. Pet. App. 24a.

SUMMARY OF ARGUMENT

1. The Court of Appeals correctly held that the PBGC's decision to restore the terminated Plans because of the changed financial circumstances of LTV was arbitrary, capricious and utterly unjustified under the circumstances. The PBGC's decision has had a devastating effect on the efforts of LTV, the nation's third largest steel producer and a major defense and aerospace manufacturer, to reorganize under Chapter 11, and has delayed for years payments to LTV's other creditors.

The terminated Plans can be restored by the PBGC if—and only if—they would be affordable and viable for the foreseeable future. The mere existence of post-termination pension arrangements that the PBGC considers to be abusive, regardless of whether such post-termination pension arrangements are or are not violative of applicable law, cannot justify restoration of the Plans. Notwithstanding the express

reviewable record, its failure adequately to apprise LTV of the grounds for restoration and its failure to give LTV adequate opportunity to rebut those grounds." Pet. App. 123a.

F. The Court Of Appeals Decision.

The Court of Appeals for the Second Circuit affirmed, agreeing with the district court's conclusion that the PBGC's restoration determination was arbitrary and capricious. Pet. App. 14a-17a.

Relying on this Court's decision in *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402 (1971), holding that an agency must consider "all relevant factors," the court held that "[b]ecause ERISA, bankruptcy and labor law are involved in the case at hand, there must be a showing on the administrative record that PBGC, before reaching its decision, considered all of these areas of law, and, to the extent possible, honored the policies underlying them." Pet. App. 14a-15a. It concluded that the PBGC had not "adequately considered the policies and goals of the bodies of law involved in this case and their interaction with each other." Pet. App. 17a. Rather, PBGC "focused inordinately on ERISA." *Id.*

Alternatively, the court held that the PBGC's analysis under ERISA, without regard to competing federal policies, was "insupportable as a matter of law." *Id.* First, the court found no support for the PBGC's adoption of a *per se* rule that the establishment of a follow-on plan by itself is a sufficient basis for restoration, noting that Congress was consistent in its refusal to include in ERISA proposed provisions outlawing follow-on plans. Pet. App. 17a-20a. The court of appeals also

agreed with the district court that the PBGC's assessment of LTV Steel's improved financial condition was seriously flawed and could not support restoration. Pet. App. 21a-25a. Finally, the court of appeals agreed that the PBGC utilized inadequate procedures.

The court of appeals remanded to the PBGC, explaining that "[o]n remand, PBGC may be able to justify its decision. However, based on the administrative record presented to the district court and to us, its decision cannot be upheld." Pet. App. 27a.

G. The Impact Of Restoration.

The status of the three Plans – terminated or restored – and the disposition of approximately $2.3 billion in unfunded pension benefit obligations affects all creditors of LTV Corp. and LTV Steel, as well as creditors of all the other Debtors. Assuming LTV Steel could afford to fund restored Plans while it and the other members of its controlled group successfully reorganize, the goals both of ERISA and of the federal bankruptcy laws would be achievable. However, an improvident restoration – one in which the impact of LTV Steel's funding obligations on the prospects of reorganization of all of the Debtors has not been properly evaluated – could well lead to imminent retermination of the Plans and the liquidation of all Debtors. Liquidation would frustrate the goals of ERISA, the Bankruptcy Code and the labor laws.

Retermination of the Plans could also have a drastic, adverse effect on all creditors in these bankruptcy reorganization cases. The 1987 amendments to the pension laws increased the

joint and several liability of terminated plan sponsors and their controlled group of corporations (which here includes the parent, LTV Corp. and LTV Aerospace & Defense Company), from 75% of unfunded guaranteed benefits to 100% of benefit liabilities. *Compare* SEPPAA, §11011(a), amending ERISA §4062(b), 29 U.S.C.A. §1362(b)(1)(A) (Supp. IV 1986) with the PPA, amending ERISA §4062(b), 29 U.S.C.A. §1362(b)(1)(A) (West. Supp. 1988). Were the PBGC to reterminate these pension plans, or were the bankruptcy court to approve a voluntary distress termination after the restoration, the PBGC might seek to increase its claim to 100% of the unfunded benefit liabilities. If the court found that the new law applied, the PBGC's claim would be increased by approximately $800 million. Pet. App. 121a. Although the Plans in question are sponsored by LTV Steel – not LTV Corp. – the prospects of recovery by parent creditors may be seriously affected by the provisions in ERISA that provide for "joint and several" liability of members of the controlled group on a termination claim.[10]

A decision by this Court as to the status of the Plans affects the interests of all LTV Corp.'s and LTV Steel's creditors, but that decision may affect each creditor constituency differently.

[10] In the bankruptcy court, the Parent Creditors' Committee objected to the PBGC's claims. These objections, which are still pending, raise the issue whether such full controlled group liability on the parent LTV Corp. violates the constitutional rights of LTV Corp. and its creditors.

SUMMARY OF ARGUMENT

1. The administrative record does not support the PBGC's Notice of Restoration of the Plans, and the courts below correctly vacated the PBGC's Notice and remanded the matter to the PBGC for further development of the factual record. An employer's adoption of a follow-on plan does not automatically justify restoration by the PBGC of a terminated plan. Congress carefully considered and explicitly rejected a proposed statutory prohibition against follow-on plans, and withheld from the PBGC the power to adopt such a "per se" rule and to use retaliatory restoration to deter this supposed "abuse" of the pension insurance program. Moreover, the courts below were correct in concluding that the PBGC's optimistic assessment of LTV Steel's financial condition was not based on an adequately-developed administrative record.

2. On remand to the PBGC, however, the PBGC should confine its consideration exclusively to the issues under ERISA involved in restoration. When the sponsor of a terminated pension plan is a debtor in the process of reorganization under Chapter 11 of the Bankruptcy Code, and pension plan obligations are a part of a collective bargaining agreement governed by the federal labor laws, the decision to give effect to restoration of the pension plan requires careful consideration by a tribunal that is familiar with the delicate and complex process of bankruptcy reorganization, of the competing and often inconsistent policies of ERISA and the purposes and mechanics of reorganization under the Bankruptcy Code.

The PBGC has neither the statutory authority nor the expertise to apply ERISA in a fashion that properly effectuates the competing, non-ERISA federal policies. On the contrary, even in the context of a Chapter 11 bankruptcy case, the PBGC may "determine" to restore solely according to ERISA standards.

The Parent Creditors' Committee concurs with the Solicitor General's suggestion that the PBGC lacks statutory authority to evaluate non-ERISA concerns in making a restoration determination. U.S. Br. at 13, 20. Therefore, in the context of the bankruptcy reorganization process, the PBGC's determination is neither self-executing, nor conclusive. Only the courts possess the statutory authority and expertise to harmonize the goals of ERISA, the federal bankruptcy laws and the federal labor laws and to give appropriate effect to a restoration determination by the PBGC in the context of a bankruptcy reorganization case under Chapter 11. Moreover, in a case such as this, where the district court has entered an order terminating a pension plan, the PBGC has no authority to undermine and contradict a prior district court termination order by unilaterally ordering restoration. Again, action by the court to vacate the prior order is required fully to implement the PBGC's restoration determination.

3. As both the PBGC and the Solicitor General concede, the standard articulated in ERISA §4041(c)(2)(B)(ii) embodies Congress' statutory harmonization of bankruptcy and ERISA concerns when a Chapter 11 debtor seeks to terminate a pension plan. Here, where the Debtors oppose

restoration and contend that the Plans should remain terminated, the same standard is applicable. Section 4041(c)(2)(B)(ii) expresses Congress' intent that pension plans continue in effect during and "ride through" the bankruptcy reorganization whenever possible. Only if the court finds that the restored pension plan obligations cannot be made a part of any successful reorganization plan, *i.e.*, one which will allow the debtors to pay their debts as restructured by and pursuant to a plan of reorganization and continue in business outside the Chapter 11 reorganization process, should a previously terminated pension plan remain terminated. Conversely, if there is a confirmable plan of reorganization that contemplates restoring the pension plans, and the PBGC, in compliance with ERISA guidelines, determines to restore, the court must confirm that plan over an alternative plan that does not provide for restoration.

I. THE COURTS BELOW CORRECTLY VACATED THE PBGC'S RESTORATION DETERMINATION.

Applying the standard set forth in the APA, 5 U.S.C. §706(2)(A),[11] the court of appeals held that

[11] Although the PBGC does not clearly articulate the standard of review it advocates, it cites *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). PBGC Br. at 18. In *Chevron*, which dealt with the deference to be given to an administrative agency's interpretation of a statute when the statutory scheme is ambiguous or silent, the Court stated that "[i]f Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." Id. at 843-44. The Court said that if the legislative delegation is implicit rather than explicit, "a

the PBGC acted arbitrarily and capriciously in making a determination to restore LTV Steel's three, previously-terminated pension plans. The court concluded that the PBGC acted arbitrarily and capriciously in basing restoration on the fact that LTV Steel's interim labor agreement replaced some of the benefits lost as a result of termination and in fashioning a *per se* rule that replacement of benefits constitutes an "abuse" of ERISA's pension termination insurance program sufficient by itself to justify restoration. The court of appeals also concluded that the PBGC's finding that LTV Steel's and LTV Corp.'s[12] financial condition had improved sufficiently to allow them to fund restoration was unsupported by the administrative record. In addition, the court of appeals based its decision on the PBGC's failure adequately to consider competing federal bankruptcy and labor law policies.

NOTES *(Continued)*

court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency." *Id.* at 844. Thus, if the agency's interpretation is either arbitrary or capricious or unreasonable, it may be overturned.

In *Marsh v. Oregon Natural Resources Council*, 109 S. Ct. 1851, 1861 n.23 (1989), the Court noted that "the difference between the 'arbitrary and capricious' and 'reasonableness' standards is not of great pragmatic consequence." Accordingly, whether the Court applies the *Chevron* standard or the "arbitrary and capricious" standard under the APA is of little practical significance here.

[12] Although the court of appeals in its opinion referred to LTV Corp. and LTV Steel collectively as "LTV" and the briefs of both the PBGC and the United States in this Court perpetuate this confusion, the separate corporate existence of LTV Corp. and LTV Steel is important to observe in the context of these bankruptcy reorganization cases because of the distinct statutory obligations and the differences in the composition of the creditors of the respective members of the corporate group.

The courts below correctly invalidated the PBGC's Notice of Restoration based on the first two grounds, which, considered together or independently, warrant affirmance of the judgment on review by this Court.

A. The PBGC's Conclusion, That The LTV Steel Interim Collective Bargaining Agreement Was "Per Se" Abusive Of The Pension Termination Insurance Program And Therefore Justified Restoration, Was Unreasonable.

As the PBGC frames the question presented in this case, the issue is whether "a reviewing court [may] foreclose the [PBGC] from considering whether restoration is appropriate to remedy abuse of the federal pension insurance program." PBGC Br. at (i). Clearly, this is not the issue.[13]

[13] Although the PBGC and the United States have also identified as an issue the question whether LTV Steel pension liabilities are "pre-petition debts" enjoying "no special priority," or administrative expenses under 11 U.S.C. §503(b), entitled to first-level priority under 11 U.S.C. §507(a)(1), See PBGC Br. at 37-38, U.S. Br. at 22-23, n.18, and have referred to confusing language in the court of appeals' decision, Pet. App. 23a-24a, this court does not have before it any issue concerning the priority of whatever claims exist or may arise, whether on terminated plans or restored plans. The Parent Creditors' Committee would dispute the Debtors' argument that restoration is meaningless because LTV Steel cannot make contributions while it is in the process of reorganization before confirmation of a plan of reorganization "without an extraordinary court order." *See* Brief for Appellees, the LTV Corporation, The LTV Steel Company, Inc., *et al.* in No. 88-6244 (2d Cir.), pp. 40-41, n. **, and takes issue with the Debtors' refusal in December 1986, to make contributions to the Plans because LTV Steel "is currently in reorganization under Chapter 11 of the Bankruptcy Code." JA 125-126.

Nonetheless, these questions and the many subsidiary issues flowing from them are not properly before this Court. Although these issues are important to bankruptcy administration in these and other cases, the bankruptcy court here has not yet definitively dealt with them. This Court should avoid addres[illegible]ng these issues prematurely before the courts below have had a full opportunity to

Neither the court of appeals nor the district court held that the PBGC was precluded from restoring a pension plan when an "abuse" had occurred. Indeed, if an employer "abuses" the system by shifting to the federal pension insurance program liabilities that the employer can actually afford, the decisions of the courts below would not prevent the PBGC from determining that restoration is appropriate. Moreover, in considering restoration and in evaluating an employer's ability to fund a pension plan, the PBGC is not foreclosed by anything in the decisions of the lower courts in this case from considering the cost of a follow-on plan. The employer's willingness and ability to pay the cost of such a follow-on plan is clearly one relevant fact to consider in determining whether an employer has the financial capability to fund the entire plan in its original form.

Rather, the question presented here is whether PBGC has erroneously fashioned and applied a *per se* rule that whenever a sponsoring employer, after it has terminated a pension plan, adopts a follow-on plan that substantially replaces nonguaranteed benefits, such a follow-on plan constitutes an abuse and whether, under such circumstances, ERISA §4047 confers upon the PBGC the power to restore the original pension plan. *See,*

NOTES *(Continued)*
explore them. However, in view of the confusion engendered by certain language in the court of appeals' opinion, this Court may wish to invite the court of appeals on remand to clarify its discussion of these issues, in which it appears to have blurred the crucial distinction between statutory termination liability claimed by the PBGC and post-petition contributions payable by a sponsoring employer to ongoing pension plans.

e.g., PBGC Br. at 23. Under the PBGC's construction of §4047, the PBGC need consider neither the employer's ability to fund the plan nor any of the other considerations upon which the previous involuntary termination of the plan rested.

The PBGC's unreasonable interpretation of §4047 was properly rejected by both the district court and the court of appeals below.

1. The Courts Below Correctly Rejected As Unreasonable The PBGC's Contention That ERISA §4047 Authorizes Restoration As A Sanction For Adoption Of A Follow-On Plan.

Section 4047 of ERISA provides that the PBGC may "take such actions as may be necessary to restore" a terminated pension plan where the PBGC "determines such action to be appropriate and consistent with its duties" under ERISA.[14]

[14] Section 4047 of ERISA, 29 U.S.C. §1347, provides:

Whenever the corporation determines that a plan which is to be terminated under section 4041 or 4042, or which is in the process of being terminated under section 4041 or 4042, under this subtitle should not be terminated under section 4041 or 4042 as a result of such circumstances as the corporation determines to be relevant, the corporation is authorized to cease any activities undertaken to terminate the plan, and to take whatever action is necessary and within its power to restore the plan to its status prior to the determination that the plan was to be terminated under section 4041 or 4042. *In the case of a plan which has been terminated under section 4041 or 4042, the corporation is authorized in any such case in which the corporation determines such action to be appropriate and consistent with its duties under this title, to take such action as may be necessary to restore the plan to its pretermination status, including, but not limited to, the transfer to the employer or a plan administrator of control of part or all of the remaining assets and liabilities of the plan.*

The duties of the PBGC under ERISA, as enumerated in §4002(a), 29 U.S.C. §1302(a) are:

(1) "to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,"

(2) "to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which this title applies," and

(3) "to maintain premiums established by the corporation under section 4006 at the lowest level consistent with carrying out its obligations under this title."

ERISA also imposes other duties on the PBGC. These include involuntary termination of single-employer pension plans under certain circumstances. ERISA *requires* the PBGC to terminate a plan when "the plan does not have assets available to pay benefits which are currently due under the terms of the plan." *See* ERISA §4042(a), 29 U.S.C. §1342(a). It gives the PBGC the authority to terminate a plan when "the plan will be unable to pay benefits when due" or when "the possible long run loss of the corporation with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated." *Id.*

When it started proceedings to terminate the three Plans at issue in this case, the PBGC found that LTV Steel was unable to meet ERISA's minimum funding standards, that without termination the severe underfunding of the Plans would increase, and that termination was required to

"avoid an unreasonable deterioration of the Plans' financial condition or an unreasonable increase in the liability of the PBGC." Pet. App. 42a. *See* PBGC Br. at 9; JA 140; AR 1257, 1384, 1507. Thus, the PBGC determined that it is appropriate and consistent with its duties to terminate pension plans under those circumstances.

In light of its own stated reasons for terminating the Plans, the PBGC's contention that restoration is justifiable, without more, simply as a deterrent measure to discourage the establishment of follow-on plans, and particularly without regard to the continued cogency of the original reasons justifying termination, is unfounded. Retaliatory restoration under such circumstances is clearly not "appropriate and consistent with [the PBGC's] duties" under ERISA, which include assuring that funding occurs and that its own liability is minimized.

2. The Legislative History Of ERISA §4047 Refutes The PBGC's Contention That Congress Intended To Entrust The PBGC With The Power To Deter Follow-On Plans With The Sanction Of Restoration.

The legislative history of ERISA §4047 shows that Congress was concerned with the financial ability of employers to fund pension plans. As the court of appeals observed, "Congress' focus in enacting section 4047 was mandating restoration if there was an improvement in financial circumstances." Pet. App. 17a. Congress intended the PBGC to take steps to restore a plan when the employer could afford to fund the terminated plan. *See* H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 378, *reprinted in* 1974 U.S. Code Cong. & Admin.

News 5038, 5157-58. In such cases, the original grounds for termination no longer exist. The court of appeals correctly observed that the "legislative history of section 4047 reveals no indication that Congress intended the establishment of successive benefit plans to be a ground for restoration." Pet. App. 17a.

As the courts below both correctly observed, Congress only specifically identified the employer's improved financial condition as an appropriate basis for restoration under ERISA. Pet. App. 17a-18a, 93a-100a. Reporting on the original provisions of ERISA in 1974, the House Conference Report states, for example, that the PBGC may cease termination proceedings "if the employer and plan enjoyed a favorable reversal of business trends, or if some other factor made termination no longer advisable." H. R. Conf. Rep. No. 1280, 93d Cong. 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5157. According to the House Report, the PBGC may restore a terminated plan "if, during the period of its operation by the trustee, experience gains or increased funding make it sufficiently solvent." *Id.* at 5158.

The legislative history of the 1986 amendments to ERISA, which contained technical changes to §4047, likewise confirms that Congress neither intended to permit the PBGC to employ restoration as a weapon to punish employers who "abused" the termination insurance program, nor expressed the view that follow-on plans constituted an abuse. In the House Report on SEPPAA, Congress specifically identified the anticipated abuses of the insurance system which it believed warranted legislative action and discussed the appropriate protection against such abuses. H. Rep. No. 241, 99th Cong. 2d Sess., *reprinted in* 1986 U.S. Code Cong. & Admin. News 685, 690-700. Significantly, this crucial piece of the legislative history of §4047 does not so much as identify follow-on plans as an abuse. Nor does it provide any indication that Congress intended to authorize the PBGC to use its power to make a restoration determination to deter any of the abuses it specifically identified.

When Congress addressed the abusive shifting of pension liabilities on the PBGC, it stated that this practice should be remedied through the new "objective criteria for employer distress" and the increase in underfunding liability to the PBGC in §4062(b) above the 30% net worth cap contained in the old law. *Id.* at 690. The House Report states "these provisions will help close the door to abusive claims against the termination insurance program." *Id.* at 690. In fact, in the course of enacting the 1987 amendments to ERISA, Congress specifically considered prohibiting replacement plans, but *declined to do so. See, e.g.,* House Conf. Rep. No. 495, 100th Cong., 1st Sess., *reprinted in* 1987 U.S. Code Cong. & Admin. News 2313-1245, 2313-1626 through 1631.

In 1987, four Congressional committees considered and recommended legislation dealing with Title IV of ERISA. Only the House Ways and Means Committee suggested legislation prohibiting replacement plans. The Ways and Means Committee noted that "*[u]nder present law, an ongoing entity* can continue in operation on a profit making basis after transferring liability to the PBGC and

> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; . . .

11 U.S.C. §1129(a)(7). In other words, in order for a plan of reorganization to be confirmed, each holder of an impaired claim or interest that has not accepted the plan—regardless of whether its class has accepted the plan—must receive or retain under the plan on account of such claim consideration having a present value at least equal to the amount it would receive or retain if the debtor were liquidated under Chapter 7 of the Bankruptcy Code. *See* S. Rep. No. 989, 95th Cong., 2d Sess. 126, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5912. Indeed, if the Plans are restored and the Committee determines that unsecured creditors of LTV Steel will recover more on their claims in a Chapter 7 liquidation than pursuant to a Chapter 11 plan of reorganization and, if the situation is not rectified by retermination of the restored Plans, the Committee would be bound by its fiduciary duties to the creditors it represents to seek conversion of LTV Steel's Chapter 11 reorganization case to a Chapter 7 liquidation case pursuant to Section 706(b) of the Bankruptcy Code.

In order to consider whether restoration might prevent LTV from being able to satisfy the requirements of Section 1129(a)(7) of the Bankruptcy Code, the PBGC should have compared (a) the amount available for distribution to creditors (other than the PBGC) under a Chapter 11 plan of reorganization assuming restoration of the Plans with (b) the amount available for distribution to those creditors in a Chapter 7 liquidation, assuming termination of the Plans. Because (i) in the restoration scenario, LTV would be responsible for hundreds of millions of dollars of pension obligations that accrued or vested after the termination date for which it would not be liable in the termination scenario and (ii) the

PBGC assumes that the restored Plans would receive full payment on LTV's obligations in the restoration scenario and presumably does not anticipate full payment in the termination scenario, it is likely that, if the PBGC had considered the possibility of satisfying Section 1129(a)(7) of the Bankruptcy Code, it would have realized that restoration would have rendered reorganization of LTV impossible. Any assumption by the PBGC that liquidation of LTV in a Chapter 7 will result in a fire sale of assets which will necessarily yield lower recoveries for unsecured creditors is erroneous. Such an assumption fails to consider the provisions of the Bankruptcy Code which are designed to permit realization of going-concern values even in a Chapter 7 case. [10]

In any event, it is clear that the failure of the PBGC to even consider this crucial issue bearing on LTV's future and the viability of the restored Plans resulted in an arbitrary and capricious decision.

Restoration would also have a clear and readily foreseeable effect on the ability of LTV to satisfy Section 1129(a)(11) of the Bankruptcy Code, which requires that, as a prerequisite to confirmation of a plan of reorganization, the Bankruptcy Court must find that:

> Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

11 U.S.C. §1129(a)(11).

[10] LTV and its affiliates may continue to operate their respective businesses pending the sale of such entities as going-concerns in the context of Chapter 7 liquidation proceedings. *See* 11 U.S.C. §721. Thus, it would be improper for the PBGC to assume that conversion to Chapter 7 would result in the loss of going-concern values. In addition, because Section 1113 of the Bankruptcy Code does not apply in Chapter 7 liquidation proceedings, the estates would have an enhanced ability to reject the interim labor agreement, enabling LTV or the bankruptcy trustee to effectuate a distress termination of the Plans under ERISA.

Thus, plans of reorganization for LTV can be confirmed only if LTV would likely be able to meet its future obligations (including its obligations to the restored Plans) and if the plans of reorganization provide for all material contingencies—such as retermination—which could ultimately result in LTV being required to undergo further financial reorganization or liquidation. *See Pizza of Hawaii, Inc. v. Shakey's, Inc.*, 761 F.2d 1374, 1382 (9th Cir. 1985) (plan was not feasible where debtor failed to provide for enormous contingent debt).

The PBGC failed to consider whether (a) LTV would likely be able, following confirmation of its Chapter 11 plans of reorganization and for the foreseeable future, to meet both its obligations to creditors under the plans of reorganization and to the restored Plans under ERISA and (b) it would be practicable in plans of reorganization to provide for the possibility of retermination of the restored Plans. Again, this failure resulted in an arbitrary and capricious restoration decision.

As demonstrated above, restoration of the Plans would have a clear and readily foreseeable impact on the ability of LTV to satisfy key express requirements of Chapter 11 of the Bankruptcy Code for confirmation of plans of reorganization. As a result, restoration of the Plans might well force LTV into liquidation proceedings under Chapter 7 of the Bankruptcy Code or put the Bankruptcy Court into the position of authorizing retermination as the only means of permitting LTV's survival. In either event, the restored Plans would be reterminated. Inasmuch as ERISA was amended after the original termination date so that the provisions which would be applicable to computation of the PBGC's retermination claims against LTV are far more favorable to the PBGC than the provisions governing computation of its original termination claims, the PBGC would reap a windfall from its own improper restoration decision. *Compare* ERISA Section 4062 before and after enactment of the PPA (removal of seventy-five percent cap on termination liability under Section 4062(b)). The PBGC's failure to even consider the effect of restoration on LTV's ability to satisfy those express Bankruptcy Code prerequisites to plan confirmation clearly renders its decision to restore the Plans arbitrary and capricious. More to the point, the fact that the PBGC so acted without considering whether it was triggering the liquidation of the third largest producer of steel in the United States and a major aerospace and defense contractor is simply unconscionable.

C. The PBGC's Failure To Consider The General Unsecured Status Which Would Be Accorded To Plan-Related Claims Even In The Event Of Restoration Was Arbitrary And Capricious.

The PBGC asserts that, in the event of restoration, all of the claims arising out of LTV's contributions to the restored Plans which, absent bankruptcy, would have been payable during the pendency of the Chapter 11 cases would be entitled to administrative priority. The PBGC is wrong. Except for claims based upon benefits earned by post-petition services, the pension claims at issue are derived from labor provided by LTV Steel's employees prior to the filing of the petitions and thus are pre-petition claims not representing "actual and necessary" expenses of preserving the Chapter 11 estates entitled to administrative status. *See* Pet. App. 23a. By failing to appreciate that even in the event of restoration the Plans would only receive partial payment on their claims against LTV, the PBGC ultimately miscalculated the viability of the Plans if restored. In fact, there is no indication that the PBGC ever considered this factor in determining the potential viability of the restored Plans.

Section 101(4) of the Bankruptcy Code defines "claim" to mean:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, fixed, contingent, matured, *unmatured*, disputed, undisputed, legal, equitable, secured, or unsecured ....

11 U.S.C. §101(4) (emphasis added). The legislative history of 11 U.S.C. §101(4) reveals that Congress intended to define pre-petition claims broadly:

> The definition is any right to payment, whether or not reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal equitable, secured, or unsecured.... By this broadest possible definition, and by the use of the term throughout the title 11, especially in subchapter I of chapter 5, the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits that broadest possible relief in the Bankruptcy Court.

H.R. Rep. No. 595, 95th Cong., 2d Sess. 309, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6266; *see also* S. Rep. No. 989, 95th Cong., 2d Sess. 21-22, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5807-08. The broad definition of "claim" is central to the policy of a "fresh start" for a debtor and permits a debtor to receive the "broadest possible relief in the bankruptcy court," because liability on a "claim" can be discharged only by the confirmation of a plan of reorganization. *Id.; see* 11 U.S.C. §§ 101(11), 1141(d); *see also In re A.H. Robins Co.*, 63 B.R. 986, 989 (E.D. Va. 1986), *aff'd sub nom., Grady v. A.H. Robins Co.*, 839 F.2d 1908 (4th Cir. 1988); *In re Remington Rand Corp.*, 836 F.2d 825 (3d Cir. 1988); *In re Robinson*, 776 F.2d 30, 34 (2d Cir. 1985), *rev'd on other grounds*, 479 U.S. 36 (1986).

An analysis of the pertinent provisions of ERISA reveals that the majority of the contributions to the restored Plans would constitute claims as of the petition date which arose from pre-petition services and events.

Among the most important features added to the law by ERISA to promote pension plans and afford employees and retirees reasonable security were the minimum funding requirements. S. Rep. No. 383, 93rd Cong., 1st Sess. 81, *re-*

printed in 1974 U.S. Code Cong. & Admin. News 4890; H.R. Rep. No. 533, 93rd Cong., 1st Sess., *reprinted in* 1974 U.S. Code Cong. & Admin. News 4639. Prior to ERISA, the only funding requirement for a pension plan (in order to remain qualified under the Internal Revenue Code) was simply to pay its normal (*i.e.*, current year) cost and to pay interest on its past service liability (*i.e.*, the cost of providing benefits for years of service before the plan was established, or before a benefit improvement was adopted). Recognizing that the law at the time did not even require an employer to begin reducing its past service liabilities, Congress adopted minimum funding standards designed to fund those existing liabilities over time. *See* 26 U.S.C. § 412(b) and 29 U.S.C. § 1082.

As enacted by ERISA, the minimum funding rules require an employer to make an annual contribution at least equal to the sum of (1) the normal cost of the plan for the plan year, and (2) the amount necessary to amortize (i) the pre-ERISA unfunded past service liability over 40 years, (ii) post-ERISA unfunded past service liabilities over 30 years, (iii) the plan's net experience loss over 15 years, (iv) the plan's loss resulting from changes in actuarial assumptions over 30 years, and (v) funding waivers over 15 years. 26 U.S.C. §412(b); 29 U.S.C. 1082(b).[11] Thus, one of the purposes of the funding requirements is to set the minimal annual rate at which a pension plan's past service liability is to be funded. Nothing in the minimum funding requirements, however, changes the

[11] The minimum funding provisions were amended by PPA §9307 to change the amortization periods for experience losses, changed actuarial assumptions and funding waivers. In addition, Section 412(l) was added by PPA §9303 (subject to special rules for steel companies) to require additional funding for certain underfunded plans. Those changes were not applicable to the Plans when they were involuntarily terminated in January 1987. More importantly, even as amended by the PPA, the minimum funding requirements continue to recognize the distinction between normal cost and past service liability.

fact that past service liabilities are existing obligations; ERISA merely provides for the period over which such liabilities are to be paid.[12]

To put it in context, the past service liabilities under the plans which existed immediately prior to the filing of Chapter 11 petitions are neither increased nor decreased by subsequent service by covered employees. The fact that under ERISA, an employer may amortize those past service liabilities in future years does not change the fact that those liabilities constituted claims as of the filing date which, except to the extent expressly given priority, are merely general unsecured claims. Since the past service liabilities constituted claims as of the petition date, they cannot be administrative expenses.[13]

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[12] Moreover the minimum funding rules under ERISA recognize a distinction between current normal costs and past service liabilities.

[13] The Committee recognizes that in *Columbia Packing Co. v. Pension Benefit Guar. Corp.*, 81 B.R. 205 (D. Mass. 1988), the court addressed the priority status of the PBGC's due and unpaid contribution claims and concluded that the entire statutory funding obligation, including the past service liability cost, which became due during the post-petition period represented an expense entitled to administrative priority. *Id.* at 207-09. Accordingly, the court held that "the amount of an employer's contribution that is payable under Sections 507(a)(1) and (4) is the amount of the standard funding account deficiency that accrues, on a daily basis, during the priority period, which amount is adjusted to reflect the true normal cost chargeable to the funding account during that period." *Id.* at 210. This Court should not follow *Columbia Packing*. The decision cannot be reconciled with existing case law, *see Pet. App. 23a-24a; Trustees of Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98 (2d Cir. 1986), which established that the resolution of the administrative priority issue turns on when the employees provided labor in consideration for receiving pension benefits from the debtor, not the date on which the debtor's payments fall due. Indeed, under the rationale of *Columbia Packing*, a debtor's pre-petition obligations in respect of its underfunding of benefits earned by thousands of workers would be converted into an administrative expense if the debtor was obligated to make a pension contribution for the post-petition services of a single worker.

Section 507 of the Bankruptcy Code sets forth the expenses and claims against a debtor's estate that are entitled to priority. 11 U.S.C. §507. Section 507(a)(1) gives first priority to administrative expenses allowed under Section 503(b) of the Bankruptcy Code, which include claims for "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." 11 U.S.C. §503(b)(1)(A). These priorities must be narrowly construed. *See, e.g., Trustees of Amalgamated Insurance Fund v. McFarlin's, Inc.*, 789 F.2d 98, 100-01 (2d Cir. 1986); *In re United Merchants & Mfrs., Inc.*, 597 F.2d 348, 349 (2d Cir. 1979). "[I]f one claimant is to be preferred over others, the purpose should be clear from the statute." *Nathanson v. National Labor Relations Bd:* 344 U.S. 25, 29 (1952). The claimant must bear a heavy burden to establish entitlement to administrative priority. *See In re Chateaugay Corp.*, 102 B.R. 335, 353 (S.D.N.Y. 1989), *appeal docketed*, No. 89 Civ. 6687 (S.D.N.Y. Sept. 11, 1989); *In re Amfesco Indus., Inc.*, 81 B.R. 777, 785 (E.D.N.Y. 1988)("administrative priority . . . should only be granted under extraordinary circumstances, to wit, when the parties seeking priority have sustained their burden of demonstrating that their services are actual and necessary to preserve the estate").

To obtain administrative status, a claim must meet a two-part test. It must arise from a transaction with the debtor-in-possession and it must benefit the debtor-in-possession in the operation of its business. *See Trustees of Amalgamated Ins. Fund*, 789 F.2d at 101; *In re Jartran, Inc.*, 732 F.2d 584, 587 (7th Cir. 1984); *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976); *In re Chateaugay Corp.*, 102 B.R. at 353; *In re Baths Int'l, Inc.*, 31 B.R. 143, 145 (S.D.N.Y. 1983). This test is premised upon two fundamental policies underlying federal bankruptcy law, equality of distribution and rehabilitation of the debtor's business. *In re Chateaugay Corp.*, 102 B.R. at 354. Here, only a small portion of the contributions to the restored Plans would meet either part of this test. Except for the portion of the contributions attributable to bene-

fits earned by post-petition services, the claims arise from pre-petition service and events and not from any benefit provided to any of the debtors-in-possession in the operation of their businesses in Chapter 11.

Courts have consistently rejected the argument that analogous withdrawal liability under ERISA with respect to multiemployer pension plans is entitled to priority as an administrative expense incurred to preserve the estate, even if the withdrawal occurs and the withdrawal liability becomes payable after commencement of the bankruptcy case. For example, in *Trustees of Amalgamated Insurance Fund v. McFarlin's, Inc.*, the Court of Appeals determined that since the employer's lump sum payment in satisfaction of its withdrawal liability was made to guarantee pension benefits already earned by the employees covered by the plan, the consideration supporting the withdrawal liability was the same as that supporting the pensions themselves—the past, pre-petition labor of the employees covered by the plan. 789 F.2d at 101-03. Therefore, withdrawal liability was not "incurred for the benefit of the estate's creditors," *id.* at 104, and gave rise only to a general unsecured claim. *Id.* at 100, 105. *See also Amalgamated Ins. Fund v. Kessler*, 55 B.R. 735, 740 (S.D.N.Y. 1985) (withdrawal liability is "merely a substitute for the continuing contributions a withdrawing employer would otherwise make toward fully funding vested benefits. [The debtor's] liability for its share . . . of unfunded vested benefits existed long before the start of the Chapter 11 proceeding. Thus, withdrawal liability is not a cost of business activity occurring during the Chapter 11 proceeding"); *In re United Dep't Stores, Inc.*, 49 B.R. 462, 465-66 (S.D.N.Y. 1985) (withdrawal liability is not an actual, necessary cost and expense of preserving the estate); *In re Kessler*, 23 B.R. 722, 723-26 (S.D.N.Y. 1982) (pre-petition services of employees neither confer actual value upon estate nor aid in its preservation), *aff'd*, 55 B.R. 735 (S.D.N.Y. 1985) [14]

In attempting to rebut the Court of Appeals' conclusion that LTV's obligations to the restored Plans would receive "no special priority," the PBGC cites *In re Pacific Far East Line, Inc.*, 713 F.2d 476 (9th Cir. 1983). Brief for Petitioner at 38. The PBGC's reliance on this case is misplaced; in fact, *Pacific Far East* lends support to the view that the claims should be considered pre-petition claims.

The obligations that were in dispute in *Pacific Far East* had all accrued after the debtor had filed its bankruptcy petition and were directly related to services rendered post-petition. The argument against treating those obligations as administrative expenses was based on the fact that the amounts of the obligations were calculated with reference to hours worked prior to the bankruptcy filing. The court found, however, that those pre-petition hours were merely the "units of measure for the post-filing payments". 713 F.2d at 479.

The Committee does not dispute that the portions of LTV's obligations to the Plans for benefits that were earned by post-petition services are entitled to administrative priority even though the employee's number of years of pre-petition service may be taken into consideration in calculating the amount of the benefit earned. However, the great majority of LTV's obligations to the Plans accrued pre-petition. Thus, even though many of the payments actually came due or will come due (in the event of restoration) post-petition or even post-confirmation, these payments are clearly based on pre-petition obligations. This is no different than LTV's obligations to bondholders who loaned money pre-petition and were not scheduled to be repaid until some time in the future. The

[14] The fact that these cases deal with liabilities resulting from withdrawal from pension plan funding responsibility rather than with restoration liability is irrelevant to the basic issue, which is when the service for which the pension obligations accrued was performed. The only difference is that in the event of restoration, the plans would be ongoing.

critical factor is when the labor or the money was provided to the debtor, not when payment by the debtor was due. *Id.* at 478.

Throughout its papers, the PBGC either states or implies that a finding that the claims of the restored Plans are general unsecured claims will have serious implications for the pension insurance program. Brief for Petitioner at 37. In a different but comparable context, this Court made it clear that however compelling a policy argument the government might present, the equitable distribution principles embedded in the bankruptcy laws cannot be shunted aside except to the extent that Congress expressly so declares:

> The [NLRB] argues that the interest of the United States in eradicating unfair labor practices is so great that the back pay order should be given the additional sanction of priority in payment. Whether that should be done is a legislative decision. The contest now is no longer between employees and management but between various classes of creditors. The policy of the National Labor Relations Act is fully served by recognizing the claim for back pay as one to be paid from the estate. The question whether it should be paid in preference to other creditors is a question to be answered from the Bankruptcy Act... The theme of the Bankruptcy Act is "equality of distribution" (*Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219, 85 L.Ed. 1293, 1298, 61 S.Ct. 904, 907); and if one claimant is to be preferred over others, the purpose should be clear from the statute. We can find in the Bankruptcy Act no warrant for giving these back pay awards any different treatment than other wage claims enjoy.

Nathanson, 344 U.S. at 28-29. *Accord National Labor Relations Bd. v. Martin Arsham Sewing Co.*, 873 F.2d 884, 888 (6th Cir. 1989) (NLRB effort to collect judgment against debtor in bankruptcy from president and sole stockholder of debtor was rejected since, by such action, NLRB was "indirectly attempting to obtain an impermissible priority over other creditors"); *Equal Employment Opportunity Comm'n v. Rath Packing Co.*, 787 F.2d 318, 327 (8th Cir.) ("payment of EEOC claim, a pre-petition unsecured claim, may not be given preference over the claims of other creditors"), *cert. denied*, 479 U.S. 910 (1986).

Moreover, under the Bankruptcy Reform Act of 1978, Congress amended the federal statute which had given the federal government, as creditor, priority status, so that it no longer applies in Bankruptcy Code cases. *See* 31 U.S.C. §3713; H.R. Rep. No. 595, 95th Cong., 2d Sess. 220, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6179.

In fact, Congress has specifically considered the issue and expressly provided a limited priority for claims arising out of pension plan liabilities. Section 507(a)(4) of the Bankruptcy Code (which section is applicable in both Chapter 11 and Chapter 7) gives a priority to certain "allowed unsecured claims for contributions to an employee benefit plan..." This priority is limited, however, to claims arising within 180 days before the date of the filing of the petition. The Bankruptcy Code further limits the amount of the priority that can be accorded under Section 507(a)(4) and Section 507(a)(3), which gives a priority to claims for wages earned within 90 days before the bankruptcy filing, to $2,000 per employee.[15] The fact that Congress has expressly granted priority status for certain pension claims is further evidence that Congress did not intend for claims such as those at issue here to have priority status.

In making its restoration decision involving the Plans sponsored by LTV, a Chapter 11 debtor, the PBGC should have considered the level of recovery likely to be realized by the restored Plans on their claims in order to assess their viabil-

[15] LTV has already made numerous payments in respect of the priorities provided under Bankruptcy Code Sections 507(a)(3) and (a)(4), and those payments more than offset in full any claim of priority that the restored Plans might otherwise have.

ity. In doing so, the PBGC should have recognized that the great majority of the liabilities of LTV to the Plans—including all amounts, whenever they would have become payable under ERISA, relating to pre-petition services, and related actuarial changes, experience adjustments and waivers—are pre-petition general unsecured claims and can be permanently discharged pursuant to a Chapter 11 plan of reorganization even though the restored Plans may receive substantially less than full payment.[16] Unless the restored Plans can survive the inevitable shortfall in payment on their claims, they cannot reasonably be considered viable.

III. THE PBGC'S FAILURE TO GIVE ADEQUATE CONSIDERATION TO THE BANKRUPTCY AND LABOR LAW IMPLICATIONS OF ITS RESTORATION DECISION WAS ARBITRARY AND CAPRICIOUS.

In reaching its decision to restore the terminated Plans, the PBGC completely ignored the competing policies and goals served by bankruptcy and labor law—policies and goals correctly considered by the Court of Appeals. The PBGC's failure to consider the circumstances of a debtor attempting to reorganize and, at the same time, seeking to comply with its legally mandated collective bargaining obligations renders the PBGC's restoration decision arbitrary and capricious.

Since an analysis of LTV's financial condition involves competing policies of federal bankruptcy and labor laws and,

[16] This does not mean that it is impossible for a Chapter 11 debtor—even an insolvent one—to emerge from Chapter 11 with its defined benefit plans intact. If the parties in interest in a Chapter 11 case conclude that it is desirable to have the plans survive the Chapter 11 case, the funding deficiencies which would otherwise occur by reason of the discharge of and discounted payment on the claims of the plans can be avoided by either leaving the claims unimpaired under the plan of reorganization or excluding such claims from discharge in the plan of reorganization or the order confirming the plan of reorganization. *See* 11 U.S.C. §§1124, 1141(d). Given the substantial insolvency of LTV and the enormous impact of the PBGC's claims, it is inconceivable that the parties would agree to such treatment of the claims of the Plans here.

thus, implicates national policy beyond the PBGC's area of expertise, the PBGC's affordability theory as applied to this case is not entitled to any deference. *Department of the Navy v. Federal Labor Relations Auth.*, 836 F.2d 1409, 1410 (3d Cir. 1988) ("an agency decision is not entitled to such deference when it interprets another agency's statute or resolves a conflict between its own statute and the statute of another agency"); *Parola v. Weinberger*, 848 F.2d 956, 959-60 (9th Cir. 1988); *State of Nebraska Military Dep't v. Federal Labor Relations Auth.*, 705 F.2d 945, 948 (8th Cir. 1983); *Division of Military & Naval Affairs v. Federal Labor Relations Auth.*, 683 F.2d 45, 48 (2d Cir. 1982), *cert. denied*, 464 U.S. 1007 (1983); *Tsosie v. Califano*, 651 F.2d 719, 722 (10th Cir. 1981) (Secretary of HEW's construction of agency regulations "is not entitled to special deference to the extent that it rests on the interpretation of another agency's statutes and regulations.").

As the Court of Appeals correctly recognized, "[a]lthough this case arose under ERISA, the competing policies of bankruptcy and labor law must also be accorded due weight." Pet. App. 16a. The PBGC, however, not only failed to balance these competing statutory schemes but ignored them completely. The PBGC ignored LTV's status as a debtor and its efforts to reorganize and survive as a viable company. As the Court of Appeals stated:

> The purpose of a Chapter 11 reorganization under the Bankruptcy Code "is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders." H.R. Rep. No. 595, 95th Cong., 2d Sess. 220, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6179.

Pet. App. 15a.

Congressional support for reorganizations and its recognition of the importance of the protections afforded a debtor attempting to reorganize cannot be disputed. *See, e.g., Con-*

tinental Illinois Nat'l Bank & Trust Co. v. Chicago Rock Island & Pacific Ry. Co., 294 U.S. 648, 676 (1935). The two policies served by reorganization are the fresh start given to a debtor and the fair and equitable distribution of the debtor's assets to its creditors. *Continental Illinois Nat'l Bank & Trust Co., supra; see also National Labor Relations Bd. v. Bildisco & Bildisco*, 465 U.S. 512, 528 (1984); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 202 (1983).

Similarly, since the post-termination pension arrangements were negotiated through collective bargaining between LTV and the USWA, the Court of Appeals also recognized that the PBGC should have considered labor law as well as bankruptcy law and ERISA:

> A fundamental aim of the National Labor Relations Act is the establishment and maintenance of industrial peace to preserve the flow of interstate commerce. Central to achievement of this purpose is the promotion of collective bargaining as a method of defusing and channeling conflict between labor and management. *First Nat'l Maintenance Corp. v. NLRB*, 452 U.S. 666, 674 (1981) (citation omitted).

Pet. App. 15a-16a.

The PBGC, however, contends that it properly ignored the policies underlying bankruptcy and labor law since "[w]hatever the validity of this technique of judicial review in other contexts, it is inapplicable here by virtue of the plain language of Section 4047." Brief for Petitioner at 40. The PBGC's assertion that it has no authority to consider competing federal policies is inconsistent with its claim that it is entitled to the deference it seeks; if the PBGC is incapable or unwilling to consider bankruptcy and labor law in a case such as this, it is obvious that the reviewing Court is the proper authority to consider the competing federal policies, without giving undue weight to the PBGC's narrow and parochial viewpoint.

The PBGC's position is defective on numerous counts. First, the PBGC ignores Section 514(d) of ERISA which "explicitly states that '[n]othing in this subchapter shall be construed to alter, amend, modify, invalidate, impair or supersede any law of the United States (except as provided in Sections 1031 and 1137(c) of this title [Sections 111 and 507(c) of ERISA]) or any rule or regulation issued under any such law.'" 29 U.S.C. §1144(d); Pet. App. 16a. Thus, the Court of Appeals required that "the policies and goals of ERISA must be accommodated along with those of bankruptcy and labor law." Pet. App. 16a. This accommodation is precisely what the PBGC failed to perform in examining the financial circumstances of LTV.

Moreover, the PBGC's position fails to take into account Section 1113 of the Bankruptcy Code. Enacted in response to this Court's ruling in *Bildisco, supra*, Section 1113 sets forth the procedural and substantive requirements for amendment of collective bargaining agreements during a Chapter 11 case. It has consistently been recognized that Section 1113 "is meant to encourage collective bargaining." *In re Century Brass Prods., Inc.*, 795 F.2d 265, 273 (2d Cir.), *cert. denied*, 479 U.S. 949 (1986). Pursuant to this section, a debtor must negotiate in good faith over any proposed modification of a labor contract. *Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82, 89 (2d Cir. 1987).

LTV recognized its statutory obligations under Section 1113 and negotiated in good faith with the USWA over, among other things, the subject of pension benefits. Absent these negotiations, and the eventual implementation of the post-termination pension arrangements, a strike could have utterly destroyed LTV's reorganization efforts. Thus, in addition to alleviating the hardship caused to LTV's employees and retirees, the post-termination pension arrangements comported with both bankruptcy law, by permitting LTV to reorganize, and labor law, by preserving labor-management peace.

The PBGC's assertion that the Court of Appeals' holding might require an agency's decision to be invalidated if there exists an "arguably relevant statutory policy that was not considered," is a strained interpretation of the decision and is utterly unpersuasive in this situation. The bankruptcy and labor law implications of restoration in this case are more than just "arguably relevant"—they are crucial to any realistic analysis of LTV's status, financial condition and prospects. Nor are the effects of restoration on these bankruptcy and labor law concerns merely speculative and tangential—they are direct, readily foreseeable and devastating. To accept the PBGC's argument that it could take whatever action it deemed appropriate without any regard for LTV's relationships with the rest of the world and its obligations under other federal laws would result in an obvious abuse of the PBGC's discretion. The Court of Appeals thus properly held that the PBGC's failure to consider bankruptcy law and labor law, along with their underlying policies, in deciding to restore the terminated Plans rendered the PBGC's decision arbitrary and capricious.

CONCLUSION

The decision of the Court of Appeals should be affirmed in its entirety.

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